To: Economic.Dispatch@hq.doe.gov

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From: Arizona Electric Power Cooperative, Inc.

Re: Reply to Letter from David H. Meyer to David Mohre of NRECA dated September 1, 2005

Date: September 21, 2005

Arizona Electric Power Cooperative, Inc. ("AEPCO"), is a member of the National Rural Electric Cooperative Association (" NRECA"), and hereby submits this reply to the letter dated September 1, 2005 from Mr. Meyer to Dave Mohre of NRECA regarding DOE's study of economic dispatch as directed by the Energy Policy Act of 2005.

By way of background, AEPCO is a non-profit rural electric generation and transmission cooperative based in Benson, AZ. AEPCO operates within and is a member of the WECC. AEPCO is not a participating generator of any RTO or centralized dispatching arrangement, such as the California ISO. While AEPCO operates only at wholesale, AEPCO considers itself to be a load-serving entity for its six member distribution cooperatives, which are located primarily, but not exclusively, in Arizona. AEPCO generates much of its own power at its Apache Generating Station in Cochise, Arizona, but AEPCO also buys and sells power from and to other utilities under both spot and long-term arrangements.

AEPCO utilizes economic dispatch principles in its generation and power purchase and sales activities. AEPCO dispatches its own generation, dispatches first the energy that is cheapest (taking into account physical, operating, and other constraints, such as minimum load, minimum run-time, warm-up, and ramping constraints, of its units), will substitute both economy market purchased power and power purchased under long-term contracts for its own generation when it is cheaper to do so, and will seek to sell excess generation in daily markets when it is commercially desirable to do so. AEPCO's ability to operate on a pure economic dispatch basis is also constrained by pre-existing long-term commitments for off-system power sales (including a unit-specific commitment) and for off-system power purchases.

AEPCO is not adverse to purchasing power from non-utility generators ("NUGs") and has three such long-term (5-7 year) arrangements currently in place with merchant generators, as well as one long-term arrangement with a utility generator. Such arrangements (whether with NUGs or utility generators) serve to avoid or defer the cost of constructing additional generation of AEPCO's own. Since all of AEPCO's generation is located at a single site, purchasing power from other sources, including NUGs, is helpful in terms of transmission constraints.

AEPCO generally does not discriminate between NUGs and utility generators in general, although each may have its own unique factors to be considered. In AEPCO's recent experience, utility generators in the area have generally not had excess capacity for long-term or baseload (noneconomy) power supply arrangements, but

some NUGs have sought to impose terms (often involving creditworthiness, particularly netting and closeout arrangements) that AEPCO considers to be unduly onerous.

AEPCO is very concerned that the DOE study may overstate the benefits to be achieved by economic dispatch of NUG resources by ignoring various real-world constraints that apply to potential purchasers of NUG or utility power. One such constraint noted above is the presence of long-term commitments that obligate a utility buyer to take energy from a particular unit or set of units. While such arrangements may have made sense when they were entered into (indeed, the long-term nature of the arrangement may well have been critical to the power seller for securing the financing and/or the ultimate capital recovery for the unit(s) involved), they may cease to be economically optimal over time. Such arrangements may limit the ability of power purchasers to take energy that is cheaper as more efficient generation emerges. In particular, if a prospective purchaser already has purchased sufficient capacity, then the purchaser's focus will be on whether the new seller has a lower energy cost because the capacity-related cost will already have been sunk.

Power purchase agreements entered into to fulfill PURPA obligations provide a particularly apt example of this constraint. PURPA was ostensibly intended to overcome discrimination and increase efficiency by requiring utilities to purchase power from qualifying facilities at the utilities' "avoided cost." However, avoided cost varies according to capacity adequacy conditions and changes over time, particularly with technological developments, such that contracts that were intended to be economic at the

time entered into have proven to be extremely uneconomic in many cases. Indeed, existing PURPA commitments undoubtedly serve to constrain many utilities from entering into what would be desirable contracts with NUGs.

In addition, AEPCO is concerned that the presence of daisy-chained power marketers in a transaction can also serve to make purchases of NUG power uneconomic. AEPCO's experience is that each marketer in a chain will seek to extract some mark-up, and the result is that the ultimate price often becomes undesirable, even though the transaction might have been attractive if AEPCO were able to purchase directly from the NUG at its original cost, free of the mark-ups. AEPCO appreciates that, in theory, the marketers can provide price convergence, liquidity, and arbitrage value, but particularly during periods where there tends to be excess power available, such mark-ups can negate the benefits of what might appear in theory to be more efficient generation.

Accordingly, AEPCO urges DOE to be cognizant that to the extent NUG generation may not be optimally utilized through economic dispatch, the shortfall may flow in substantial part from real-world complications and constraints that exist independent of any discrimination against NUGs.

Respectfully submitted,

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